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IN THE

Supreme Court of the United States

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

ILLINOIS LIFE INSURANCE COMPANY,
Respondent.

PETITION FOR REHEARING.

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PETITION FOR REHEARING.

Comes now the above-named respondent, Illinois Life Insurance Company, and presents this, its petition for a rehearing of the above entitled cause, and, in support thereof, respectfully shows:

1. This Court apparently has misconceived the facts and the extent of its decision at the last term of Court in *Helvering* v. *Inter-Mountain Life Insurance Company,* 294 U. S. 686, upon which the opinion heretofore filed herein was based.

2. This Court seems to have misapprehended the points of difference and the points of resemblance between the insurance company's liability for survivorship investment benefits payable upon survivorship, and death benefits payable upon death.

3. We believe that this Court has failed to perceive the

purpose of Congress in allowing life insurance companies to deduct a percentage of the mean reserves required by law in determining taxable net income.

4. It is submitted that the decision filed herein reads into the law limitations upon the right to deduct such reserves, which are not contained in the law and are in conflict with the purpose and intent of Congress in enacting the law.

In support of the foregoing assertions we respectfully direct this Court's attention to the following:

I.

The Inter-Mountain Life Insurance Company Case.

In the second sentence of the second paragraph of the opinion of the Court herein as it was originally printed and published it was said that the clause of Section 203 (a) (2) of the Revenue Act of 1928, which allows life insurance companies to deduct, *inter alia*, an amount equal to 4 per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, "is a re-enactment of Section 245 (a) (2), Revenue Act of 1921, which in *Helvering* v. *Insurance Co.* we held not to apply to assets reserved by a life insurance company against **unmatured**, unsurrendered and unpaid coupons attached to its policies." The coupons involved in the *Inter-Mountain Life Insurance Company* case, 294 U. S. 686, were *matured* coupons, and not unmatured coupons as stated in the opinion filed herein, on November 9th. On November 12th, we asked the Clerk of this Court whether the word "unmatured" in the opinion published in United States Law Week for November 10th was correct, and the Clerk advised us that it was the same as in the printed opinion on file in his office. We thereupon requested that

he confer with the Secretary of Mr. Justice Butler, who delivered the opinion. After a slight delay, the Secretary advised the Clerk that the printed opinion was erroneous and that the word should have been "matured." By far, the greater part of the brief for the Respondent herein was devoted to distinguishing the *Inter-Mountain Life Insurance Company* case from the case at bar on this very point—*i. e.*, that the reserves involved in the Inter-Mountain Life Insurance Company case covered matured liabilities wholly noncontingent in character, whereas, the reserves for survivorship investment benefits in the present case covered an unmatured liability, which unmatured liability was incidentally contingent upon persistence and survivorship. The error in the use of this word may have been merely typographical but, if it was present in the draft of the opinion considerd by this Court, it may very well be that the Court has wholly misconceived the extent of its prior decision in the Inter-Mountain Life Insurance Company case, and concluded that the Inter-Mountain case and the present case were substantially identical in their facts.

II.

Survivorship Investment Benefits Do Not Differ Essentially From Death Benefits.

Remarks of some of the Justices upon oral argument of this case indicate that the Court started with the assumption that there was a vital difference between the liability of this insurance company for death benefits and the liability for survivorship investment benefits—*i. e.*, that the liability for death benefits is contingent, whereas the liability for survivorship investment benefits is certain and noncontingent, at least when viewed from the standpoint of the insurance company.

It is evident upon further reflection that no such distinction exists. Death is certain and involves no contingency excepting as to the time when it will occur. Even in the case of the death benefit there is consequently neither uncertainty nor contingency as to the ultimate liability of the insurance company. A liability may be contingent in the sense that it is uncertain, and it is dependent upon future events whether the liability will ever become real. No such contingency exists either as to the survivorship investment benefit or as to the death benefit. A liability may be certain to occur, but still be contingent upon future events to determine *when* it will occur, as in the case of death benefits on straight, ordinary life insurance. On the other hand, the liability may be certain as to the date when it will become absolute, but be contingent as to the identity of the obligee, as in the case of the survivorship investment benefit. Of the latter two can it be said that either liability is more fixed or less contingent than the other?

It is submitted that the only proper test is whether or not the liability protected by the reserve has *matured.* If the liability has matured, as in the case of matured coupons or death claims after the death of the insured, then a debtor-creditor relationship exists between the beneficiary and the insurance company and the reserve is merely one for the payment of an existing indebtedness and is a mere solvency reserve. On the other hand, if the liability has not matured, the relationship is that of insurer-insured, and there is no existing indebtedness and the reserve is a contingent insurance reserve and deductible if the maintenance of such a reserve is required by State law.

III AND IV.

The Purpose of Congress in Permitting Life Insurance Companies to Deduct a Percentage of the Mean of Reserves Required by Law.

Apparently this court has overlooked the distinction between life insurance companies and ordinary business corporations—the distinctions which caused Congress to prescribe in the case of life insurance companies an entirely different method of determining taxable net income than that prescribed in the case of other taxpayers. Broadly speaking, in the case of the ordinary taxpayer, all receipts are gross income and to the extent that such receipts exceed losses and business expenses they are net income subject to tax. In the ordinary case, however, all such excess is "free surplus," available to the taxpayer, if a corporation, for dividends or any other corporate purpose. The case of the life insurance company is quite different. Instead of all receipts constituting gross income, Section 202 of the Revenue Act of 1928 limited the term "gross income" to mean "the gross amount of income received during the taxable year from interest, dividends, and rents." This limitation was doubtless imposed in view of the self-evident fact that premium receipts can in no sense be regarded as income inasmuch as they do not inure to the benefit of the insurance corporation, but are held almost entirely for ultimate distribution to the policyholders, and under the various State laws such liabilities are required to be protected by reserves. This feature is closely akin to the situation of a savings bank. Savings deposits are not income, because at the instant the bank has received moneys for deposit there arises a counter-balancing immediate liability of the bank to the depositor. In the case of

the life insurance company, such a liability arises to policyholders with respect to the premium and certain other receipts, excepting that instead of an immediate liability it is deferred and contingent, but under the Illinois law that liability is required to be safeguarded by reserves which prevent the insurer from ever becoming equitably entitled to the funds so set apart.

Under the opinion delivered herein, the insurance company is taxed upon receipts which are never in fact income because, under the Illinois Statute, they are required to be set aside in a reserve for ultimate distribution among the policyholders and no part thereof ever will be available to the corporation for any other purpose.

The rule announced in that opinion, moreover, results in double taxation. The investment income realized upon the survivorship investment funds is first taxed against the insurance company in the year in which the income is received by it. This same income is later again taxed as against the policyholders when the tontine fund consisting of such income and the contributions made by the policyholders is distributed among the surviving persistent members of the class. The policyholders, of course, pay no income tax upon that portion of the payment which represents return of premium or consideration paid, but they are required under the Statute (Revenue Act of 1928, Sec. 22 (b) (2)) to include in their taxable income the excess over such premiums or consideration paid. Such excess, however, will have been taxed theretofore against the insurance company as above shown.

At page 20 of the Brief for Respondent herein, we quoted from this Court's opinion in *McCoach* v. *Insurance Company of North America*, 244 U. S. 585, in part as follows:

> "The Act of Congress • • • deals with reserves not particularly in their bearing upon the solvency of

> the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation."

That was the first case before this Court involving the interpretation of a statutory provision akin to the one now before this Court. The Court then recognized the congressional intent to tax only the net income of insurance companies and to disallow only such of the reserves as did not "aid in determining what part of the gross income ought to be treated as net income for purposes of taxation." Any part of the gross receipts which is by law required to be held in a reserve to be returned or paid to the policyholders and can never be available for the general corporate purposes of the company cannot in fairness to insurance companies be treated as net income to those companies either for the purpose of taxation or for any other purpose.

The income which Congress sought to include as taxable income of life insurance companies is such as this Court in *Maryland Casualty Company* v. *United States*, 251 U. S. 342, 352, designated as "free income" or, as the Court there also stated, such as was "released to the general uses of the company and increased its free assets." We respectfully refer this Court to the discussion of the *Maryland Casualty Company* case contained at pages 21-24 of the Brief for the Respondent.

That Congress did not intend to limit the deductible reserves of life insurance companies so as to embrace only those reserves which cover liabilities maturing upon death is manifest from Section 203 (a) (4) of the Revenue Act of 1928, which expressly allows a deduction of

> "An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than 5 years from the date of the policy contract."

Here is a reserve expressly provided for which covers a liability maturing before death. The only distinctions between this and the survivorship investment reserves are that in the case of the reserves for deferred dividends, the period of deferment may be as short as 5 years, whereas in the survivorship investment case the deferment is for 20 years, and the further distinction that in the case of deferred dividends the right to receive the dividends after they are earned by the company is not contingent upon any circumstance, whereas the right to receive any portion of the survivorship investment fund is contingent upon survivorship by the insured. There is, of course, no basic difference between the nature of the fund reserved for deferred dividends and the fund reserved for survivorship investment. Each fund is made up of contributions by policyholders, plus earnings upon investment of the funds, plus accretions from lapsed policies. The incidental distinction mentioned above (that the right to receive deferred dividends is unconditionally vested, whereas, the right to receive the survivorship investment benefit is conditioned upon survivorship and persistence) seems immaterial excepting in that it only the more indelibly stamps the survivorship investment fund as an insurance fund, as compared with the deferred dividend fund.

By almost imperceptible steps in the successive decisions of this Court, the scope of the deduction for reserves, allowed by Section 203 (a) (2) of the 1928 Revenue Act and corresponding sections of earlier Acts, has been narrowed to a degree which Congress never could have contemplated when these sections were enacted. The first portion of Section 203 (a) (2) of the 1928 Act refers only to "reserve funds required by law" and is not expressly limited to life insurance reserves nor, for that matter, even to insurance reserves. We have no quarrel with the restrictions

imposed by the successive decisions of this Court limiting such deductions to insurance reserves as distinguished from solvency reserves, and even the decision in the Inter-Mountain Life Insurance Company case limiting such insurance reserves to those which cover unmatured contingent obligations. But the line in the process of construction must be drawn somewhere. And we believe that this line has been overstepped in the opinion filed herein where the Court also excludes what are unquestionably reserves—what are reserves required to be maintained under the laws of Illinois—and what are reserves covering an insurance obligation under a life insurance policy. No single decision on this question has been a radical departure from the rule announced in any preceding decision. But when the rule to be deduced from the opinion heretofore filed herein is compared with the language of the Statute, it is evident that the taxing provisions of the Statute are by implication extended beyond the import of the language used in the Statute, to embrace in taxable income what is not so specifically required by the Statute.

Even if that clause of Section 203 (a) (2), quoted above, left any doubt as to the insurance company's right to deduct such reserves as we are here concerned with, it seems that that doubt was resolved in conformity with our contentions by the further clauses in the same Section, allowing the deduction of the reserves already mentioned "plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only." This is another definite statement of Congress that some reserve funds may be de-

ductible even though they cover an obligation maturing before death. But even more clearly than that, it indicates that the purpose of Congress was to permit the deduction of such reserve funds required by law as are "necessary for the protection" of the policyholders. The policyholders are just as obviously in need of protection with respect to the survivorship investment benefits as they are with respect to death benefits, endowment benefits, cash surrender value, loan value, or any other right which they may possess under their policies.

Near the end of its opinion filed herein, this Court, speaking of life insurance liability, said:

> "Ascertainment of the reserves attributable to that liability involves consideration of the amount contributed to them out of premiums plus interest for a period *estimated* on the basis of *mortality.*" (Italics are ours.)

As above indicated, the purpose of the reserves is protection of the policyholders and the manifest purpose of Congress in allowing the deduction of a portion of the reserves is to allow the deduction of the reserves required for such protection. Some of the liabilities under the insurance policy mature upon the death of the policyholder. Inasmuch as the date of death cannot be accurately foretold and it is impossible to determine with absolute certainty how large a fund is necessary for the protection of the policyholder, it becomes necessary to resort to an *estimate.* Likewise, because of man's lack of prescience this estimate must be on the basis of *mortality.* The use of estimates and the resort to mortality tables in making those estimates result only from our human limitations and our inability to determine with greater certainty exactly when this particular liability will mature and, consequently, what reserve must be established to meet it at maturity.

It is evident therefore that estimates based upon mor-

tality are only means to an end—that end being the determination of the amount necessary for the protection of the policyholder, which in turn depends upon the time when the obligation will mature. If that end can be achieved by some other means (as it of course can with respect to insurance obligations maturing upon a fixed future date), there can be no need of resorting to estimates. When it is said that the end contemplated by the Statute has not been achieved because it was reached by a different means—even though that means may be far better, because more accurate, than the estimate ordinarily employed to determine the amount required to be reserved with respect to liabilities maturing at an uncertain date in the future—the conclusion is, in our opinion, fallacious.

Conclusion.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that upon further consideration the judgment of the Circuit Court of Appeals for the Seventh Circuit be affirmed.

Respectfully submitted,

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William M. Klein,
Samuel B. Kraus,
Attorneys for Respondent.

I, Samuel B. Kraus, one of the attorneys for the above-named respondent, Illinois Life Insurance Company, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

Samuel B. Kraus,
Attorney for Respondent.